PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Meeting of the Federal Open Market Committee
October 1, 1991

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, October 1, 1991, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Mullins
Mr. Parry

Messrs. Hoenig, Melzer, and Syron, Alternate Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Beebe, Broaddus, R. Davis, Lindsey, Promisel, Scheld, Simpson, Slifman, and Ms. Tschinkel, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Johnson, Assistant Director, Division of International Finance, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Hendricks, First Vice President, Federal Reserve Bank of Cleveland
Messrs. Balbach, J. Davis, T. Davis, Lang, Ms. Munnell, Messrs. Rolnick, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Cleveland, Kansas City, Philadelphia, Boston, Minneapolis, and Dallas, respectively

Transcript of Federal Open Market Committee Meeting of
October 1, 1991

CHAIRMAN GREENSPAN. Good morning, everyone. We have Tom Hoenig with us--officially this time--and I gather, Tom, that this is your first day as president.

MR. HOENIG. As a matter of fact it is and that's a warning to all of you.

MR. BOEHNE. It's all up hill from now on!

CHAIRMAN GREENSPAN. Would somebody like to move the minutes of the August 20th meeting?

MR. KELLEY. So move.

MR. SYRON. Second.

CHAIRMAN GREENSPAN. Without objection. Sam Cross, you have a number of issues on the table.

MR. CROSS. [Statement--see Appendix.]

Mr. Chairman, I also might take a moment to mention that we circulated a memorandum to the Committee on questions related to the investment of our German marks. As the memorandum points out, almost all of our marks are in a three-month double-forward facility with the Bundesbank. This causes a problem for the Bundesbank in terms of some mismatch between that facility and the two-month repo position that the Bundesbank uses these funds for. They are concerned and have been seeking to get some change in that facility, and we're looking into the possibility of some modification. We need to work this out, of course, with the Bundesbank and the Treasury and there are many technical questions that we have to look into.

The memorandum also suggests that we might look at some possible change in our approach more broadly. I mentioned the possibility of a three-point approach for dealing with these DM and yen balances. The first element would be that we would work out an arrangement whereby either regularly or from time to time as seems appropriate we would put the earnings we receive on these various reserve holdings back into the market or sell them in other ways. The second element would be that we would continue to look for further opportunities for off-market exchanges such as those that we carried out and are still in the process of carrying out with both the Bank of Japan and the Bundesbank and thereby reduce some of our reserve holdings in that manner if it seemed appropriate. Then, thirdly, I suggested that we might also consider some modest diversification of our facilities so that they might be less heavily focused on these very short-term, three-month facilities which are available on a two-day notice--less heavily focused in this Bundesbank facility and other similar facilities. We might think about putting a somewhat greater portion, for example, in the BIS or in some other arrangement of that sort. We'd try to work out this matter with the Bundesbank; it is causing them concern because it does put them in a position whereby they have to explain to their GAO and auditors why they have a facility with us that can cause them to make losses out of profits.

And as part of this general examination we could also consider some diversification so that we might move a small portion of the balances into somewhat longer German government paper beyond the 12-month limit that we've been held to up to this point. There's very little of this very short-term paper available in Germany, and for reasons of diversification it might be appropriate to consider a somewhat more flexible approach. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Any questions for Mr. Cross?

MR. BOEHNE. One question, Sam: What are the real prospects for off-market sales of marks?

MR. CROSS. Well, we're about halfway through the process that we worked out with the Bundesbank to cover the months from July through December. After that, I do not think the Bundesbank would be unwilling to consider some further possible exchanges next year. I mentioned as a part of the approach that we would continue to look for such opportunities. I assume there is a possibility that both we and the Bundesbank might find it in our mutual interest and therefore advisable.

CHAIRMAN GREENSPAN. Any other questions? Peter Sternlight, the Domestic Desk.

MR. STERNLIGHT. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. President Corrigan, do you want to add anything?

VICE CHAIRMAN CORRIGAN. Yes, let me just say a couple of further words on the Salomon situation. As Peter has indicated, and as I think is widely known, the status of Salomon as a primary dealer is under active review. Just so the Committee understands the way that all came about, Gutfruend called me on Friday the 9th of August and first revealed the initial violations. We sent them a letter the following Monday, which they got on Tuesday, in which we basically said that in view of what they had disclosed they had 10 days to make their case on why they should be retained as a primary dealer. That letter, I think, prompted the second round of disclosures, which didn't come easily I might add. And when the full scope of the second round of disclosures became apparent, I told them--and this was all in consultation with the Treasury and the Chairman, so I was not acting in a vacuum--that signals were off for the 10 days and that they should not conclude that the Tuesday letter meant that we might not take immediate action. And I think it's fairly clear that that message was what, in turn, prompted the decision of Strauss and Gutfruend to resign and Buffet to come on board. There was no horse trading about this. But we did decide here on Friday morning in the Chairman's office that in those circumstances we would give them a little more breathing room to make their case. So, in effect, we did give them an extension, which has now run its course. They have submitted to us a rather voluminous set of documents laying out all the changes they've made and all the changes they plan and so forth, and that is under evaluation. Nevertheless, we are rapidly approaching the point where the decision time will be at hand. Indeed, I would be very surprised if whatever decision we make is not made sometime around the middle to the end of this month. I can't see it going beyond the end of this month.

At this point, I don't want to try to prejudge that decision. And above all we recognize that the Board of Governors and the Committee have a natural and appropriate interest in both the decision and the decisionmaking process, if for no other reason--and there are others as well--that there are possible decisions in the spectrum of all that might be considered that could have very major implications not just for the firm but for markets as well. As that gets closer we will, of course, make sure that appropriate means and mechanisms are followed to satisfy those natural interests. Obviously, we will have to consult with the Treasury and the SEC as well.

Even though I don't think it has to bear on the decision, whatever it is, I can't underscore enough how large and how complex this firm is. If you look at it relative to Drexel, for example, Drexel literally looks like a fly on an elephant's behind in terms of both size and complexity. The balance sheet, as Peter said, is down to something a little over $100 billion now. But again, unlike Drexel, not insignificant parts of this balance sheet are booked in foreign offices in a multiple-currency type environment now, with significant balance sheet assets denominated in various foreign currencies. Their global operations are several orders of magnitude different from anything we've seen to date. But I think the biggest element of potential complexity is the off-balance sheet. The off-balance sheet in total notational terms is about $650 billion, isn't it Joan? [Secretary's note: Ms. Lovett replied in the affirmative.] Again, that's bigger than a bread basket. One of the things, of course, that you see when you confront this kind of situation is that although everybody says you can net positions down and all that, it doesn't work that easily in practice. The most complex element of the off-balance sheet by far is the swap book. The swap book aggregates to $320 billion; the rest of it is foreign exchange, futures, and forward mortgage-backed securities. They're complicated in their own right but one could at least visualize how those things can be taken care of. The swap book is a horse of an entirely different color. It involves multiple categories of counterparties all over the world. And the swap book was, among other things, the instrumentality through which these incredibly complex hedging positions were developed.

So, it's not as if you can take the swap book and carve it out without the carving out itself having very important implications for all the other instruments both on and off the balance sheet. And maturities in the swap book can run out as much as 10 years; they're not just interest rate swaps. Some of them are highly complex swaps that involve both interest rates and exchange rates. Some have three or four or five interest rate/swap-type transactions that are tied up with currency swaps that might involve six or seven different currencies, and that's basically one transaction. But the difficulty with the swap book other than its complexity is that writers of swaps essentially have either an implicit or offer a very explicit responsibility to buy them back and/or to make a market. Now, the problem that creates is that if the thing starts to slip, what will happen just as sure as any of us are sitting here is the counterparties that are net plus in individual swaps will put them back and the ones that are net minus will take to the hills. And that can create some rather unusual difficulties. But I say that just so people recognize that this is an extremely big and very, very complex firm. Again, it's not that that by itself bears on what one does or does not do; but it does say that, as a part of the process of coming to whatever conclusions have to be reached, we have to consider, and we are doing so seriously, possible contingencies that could arise. Mr. Chairman, I think that's all I want to say at this point.

CHAIRMAN GREENSPAN. Questions for either Jerry or Peter?

MR. BOEHNE. Well, I think the understatement in your comments is that this Committee and others in the System have some interest in all of this. This is probably not the forum, but I have some strong interests, and perhaps other people do too, not only in the implications for the financial markets--and I think you've given us a hint by talking about swaps just what some of the implications and some of the contingencies are--but also, closer to home, just how vulnerable we are as an institution in all of this. Again, this is probably not the place to talk about it, but I think it is important to talk about it in some forum.

MR. LAWARE. Jerry, would the removal of the primary dealer status bring the firm down?

VICE CHAIRMAN CORRIGAN. Well, that's obviously a tough question. The prevailing view among people in the markets here and abroad, including some very prominent foreign officials--the prevailing view among those who choose to express a view about that to me--is, yes. Now, that doesn't mean that view is right. We ourselves certainly think that is a possibility. It's one of these things that is so hard to judge.

MR. LAWARE. Yes.

VICE CHAIRMAN CORRIGAN. A second question, of course, is that even if you thought it would, how do you judge the follow-on systemically? And a propos Ed Boehne's questions, from an institutional point of view, there are risks on both sides even of that. Now, there are certainly people who say that our institutional reputation is damaged if we don't do something like that. But if we did it and it produced that kind of problem, our institutional reputation could be damaged in the opposite direction. So, it's a very, very difficult question.

CHAIRMAN GREENSPAN. What we need is a Solomon!

VICE CHAIRMAN CORRIGAN. We surely do.

MR. MELZER. Jerry, as this begins to sort itself out--I don't know what the potential is but obviously we're dealing with confidence here--it seems to me that an important part of this, if it were at all possible, is not having whatever decision is reached jumped on by key politicians right and left. I don't know what that--

VICE CHAIRMAN CORRIGAN. I think that's the thrust of Ed's comment. But there's not a win-win there that I can see.

MR. MELZER. Right.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Jerry, I think there are two kinds of responses that we can be involved in. One is the response to a firm that has violated the ethical principles in regard to falsifying reports, which is an issue in itself. But the other problem that seems to me is very important to the Federal Reserve is that we address the entire question of whether or not a small group, in a sense, ought to have that privileged access. And in that vein I'm wondering how far down the road it would be for us to be able to have an electronic ability at various firms to make their bids. I presume that takes quite a bit of software as well as hardware.

VICE CHAIRMAN CORRIGAN. Well, let me say two things about that, Wayne. First, as you know, as part of this interagency review process we are looking very hard at what steps can be taken to accelerate the programs that are already on the drawing board. I don't have a firm answer as to how much can be done to accelerate that process. It is unambiguously clear that some kind of electronic bidding system would help [alleviate] some of these problems. But it is <u>not</u> by any means a panacea. I think, for example, that what Salomon did was three things: One is that they violated the auction rules; two is that they systematically lied about it; and three is that they used the set of customer relationships that are all within existing rules to piece together these very complicated financing arrangements for themselves and their customers that produced the "squeeze." Squeezes can be good; squeezes can be bad. That's a problem in its own right. In any event, that produces these distortions either in terms of the price of the underlying security or the pricing of the RP in the marketplace. Now, those latter things, whether one thinks they're good or bad, could have been done entirely within the existing rules. That may say that the rules are wrong; but they could have been done entirely within the existing rules. And that issue in my mind is in some ways more fundamental than the fact that they broke the rules. It has nothing to do with the question of penalties, of punishments fitting the crimes, and all that. In terms of the way the market works, an electronic bidding system isn't going to do a darn thing to deal with those issues.

The other thing that is important to keep in mind is that one can at least speculate--and that's all it is--that even the most sophisticated electronic bidding system and trading system might still result in a situation, and indeed I suspect would result in a situation, in which there still would be a relatively small number of large institutional players that are going to be a very, very prominent if not dominant part of this market. In addition, even the most sophisticated electronic bidding and trading system in and of itself does not provide the answer to the question of who our counterparties are. And that's where the nub of the so-called moral hazard problem arises. Because as long as we have to deal with somebody, there has to be some kind of objective standard. In this day and age of "Government in the Sunshine" and all the rest of it, we wouldn't last 5 minutes saying: "Well, that's our business and nobody else's business." So, while the electronics can and will help a lot, and frankly in retrospect we probably--not probably, we <u>should</u> have been putting more emphasis on that--as you know very well, it was perceived as a question of priorities. We've put huge amounts of resources into the upgrading of the book entry system itself; we've put huge amounts of resources into Treasury direct; we've put huge amounts of resources in the savings bond thing; and the perception was that the auction system was working well. It didn't seem, certainly to me--and I was wrong--to be at the front end of the priority list in terms of intensive application of new technology.

MR. ANGELL. I don't want to debate all these questions at this point, but I do think it's very important that the marketplace and the public perceive that we're very sensitive to an open access bidding system and that we really ought to give a lot of priority to making certain that that option is available so that as the discussion takes place we are not seen as holding up that process.

VICE CHAIRMAN CORRIGAN. I agree completely with that. And, really--Dave has been working with us on this--we will be putting a full court press on that. But I don't want to leave the impression with anybody that once we fix that, we've fixed all these other problems because that just doesn't follow.

MR. ANGELL. I understand and I'll be very happy at some other time to talk about some of those other problems.

CHAIRMAN GREENSPAN. Any further questions?

MR. MELZER. I just want to make one follow-up comment. Thinking about what John [LaWare] was saying--and again not prejudging where this ought to come out--it seems to me that one can draw a distinction between violations in the auction process, which the Treasury oversees, and our decision with respect to primary dealers, which is whom we choose to deal with to execute our transactions. It just seems to me, getting back to John's point, that in effect as a punishment--and maybe it's perceived by some as an appropriate punishment--that implicitly the statement the Fed is making is that we're not comfortable dealing with these people. I can just imagine what the reaction will be. It will be "The Fed must know something about this that we don't know," if they say they're not comfortable dealing [with that firm]. That's a pretty serious statement, it seems to me. And if somehow a distinction could be made between those two issues--the Treasury bidding process and our role in executing transactions--which is a distinction you've made before, I think it's an important one.

MR. SYRON. The one problem with this and the reason for the extensive discussion is that it is perceived--and I think Ed's comment is very appropriate--correctly or incorrectly by many people out there that the appropriate sanction applier, if I can use that term, is the Federal Reserve. Now, if that is not how it's done--and I'm not judging that one way or another--then there has to be a way, given what happened, that that issue is somehow defused and it's clear what the sanctions are and why the Federal Reserve is not the appropriate one [to apply sanctions] and what it is that whoever is appropriate is doing.

MR. MELZER. Yes, we can suspend them from the auction process without pulling their primary dealership; that's what I'm saying.

CHAIRMAN GREENSPAN. The trouble, unfortunately, is that what we can't do is suspend them temporarily as a primary dealer.

MR. MELZER. Sure.

CHAIRMAN GREENSPAN. It's like executing somebody technically and then resuscitating them. If there are no further questions on this issue or to Peter, may I have a motion to ratify the actions of the Desk?

MR. SYRON. So move.

CHAIRMAN GREENSPAN. Is there a second?

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. We now move on to the economic discussion. Mike Prell.

MESSRS. PRELL and PROMISEL. [Statements--see Appendix.]

CHAIRMAN GREENSPAN. Questions for either gentleman?

MR. BOEHNE. Mike, that was really an excellent opening statement about the economy and where we are. I think it really summarized it quite well. I have a question about the profile of the recovery. The profile in the Greenbook is essentially a real growth rate of about 3 percent, give or take a few tenths in either direction, starting in the third quarter and going out through the forecast period. Yet, I think the typical historical pattern has been that in the initial quarters--the first two or three quarters--we tend to get a more rapid growth rate and then it begins to slow. I'm wondering in your analysis of past recoveries if you think that there is anything in the sort of jump-start dynamics earlier in a recovery that we have to have a faster growth to get it going and then it tends to slow and whether, if we only get 3 percent in the initial quarter, that's enough jump-start action to keep the recovery going in subsequent quarters.

MR. PRELL. I think that notion has some intuitive appeal. It's not something that one can discern in terms of the behavioral relationships that are sort of the averages through cycles that are embodied in econometric models. My sense is that where this in fact may be a part of the current process is that some sectors are having a more muted initial response for various reasons. The housing sector, for example, is perhaps not having as big a kick from declining mortgage rates as we've had in some past cycles, and we are not seeing a big pent-up demand for consumer durables. We didn't get a big surge initially, and this may have tended to contribute to this sense that things are really not picking up. And with the rather negative tone that I referred to earlier, in those circumstances the confidence may not be there on the part of businessmen to proceed to the next phases of restocking and pickup in investment as might have occurred previously. So, in a sense, the initial sluggishness may be continuing to retard [activity] as people just don't get the sense that things are falling in place and that they should proceed with confidence in making investments to meet future demand. So, it may be that there's some of that dynamic here. I don't see that, though, as necessarily suggesting that this [recovery] has to peter out. We have this continuation of what we think is the beginning now of a moderate growth path.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mike, this is related to Ed Boehne's question. This forecast incorporates our usual assumption of no change in rates, which you essentially had to make. In going back and looking at our forecasts historically, we have quite a substantial change in rates from what they have been. I'm wondering in going forward whether you think the difference between these expectations of rate changes and what the economy has done has been caused primarily by external differences and what is going on in the real economy. That's one factor. And how much--and you addressed this somewhat already--is it a change in the responsiveness of the economy to a fall in rates? It's impossible to give a precise weighting on that, but I'd be interested in your speculation about that, particularly going forward.

MR. PRELL. Ted Truman presented an interesting econometric result--I think it was in the chart show--which indicated in essence that to a first approximation the decline in interest rates that had occurred since the beginning of this year had effectively offset the surprise we have seen in the dollar, which we had not anticipated to appreciate as it did. Thus, if you looked at where output would be sometime out in 1992, these were compensating forces. Now, what caused the dollar to do that--whether it was exogenous events and political factors and so on or part of the internal endogenous dynamics in the economic system--is hard to say. But some political factors clearly were involved in that development.

MR. SYRON. So you might say this was different in the past and you wouldn't necessarily forecast that that would continue?

MR. PRELL. Well, I would not discount entirely the notion that some of the responses to the financial developments that we have seen in the economy may have differed from what we have observed in the past. There's a complex of factors in terms of term structure and financial flows and the credit crunch aspects of this and so on that you'd have a hard time matching up against previous history. My sense is that the key interest-sensitive sector, housing, has responded to the easing in rates; that did happen. And we expect the recent easing to continue that process. Inventory investment has been very cautious and we've been a bit surprised. On the other hand, there haven't been other things occurring that should have driven firms to restock aggressively. So, maybe things are not out of kilter there; the basic elements of the cyclical dynamics are there. And it's really hard to discern how much they've departed in degree from the past.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I have two questions. One is on nonresidential construction of structures. There has been a very protracted and also sharp fall-off for 13 quarters. Is that almost unique in terms of cyclical history?

MR. PRELL. This is an extraordinary slump.

MR. PARRY. The duration clearly is; is it the biggest drop?

MR. PRELL. Right, it's very long; it started a while back and it is very protracted by historical standards. In terms of gauging how far it might go, we think it's reasonably aligned with what we can see already in the construction contracts and permits data, which have some lead time in them. We think that there is still [in train] a significant decline in office and hotel construction and probably in other commercial construction to some degree and that we're likely to see only modest improvements over the next year or so beginning in industrial construction and maybe in some utilities construction. This just looks like a very weak sector. The vacancy rates have remained high to date despite the fall-off in construction of office buildings. We just don't see a basis at this point for an improvement there. And the financing situation is obviously not a plus. But, given the fundamentals, that's just a side story. Nobody in their right mind would finance the construction of a new building in many of the major cities.

MR. PARRY. I would assume that after that process is completed some of the major excesses that occurred prior to that would pretty well be offset. Let me ask a question on inventories. Clearly, the pattern for the next couple of quarters is going to be dramatically impacted by what happens in that area. What you had for the third quarter is the continuation of a very conservative inventory policy. We have July numbers; we have production and sales numbers for August. Are they basically consistent with a nonfarm inventory liquidation of that magnitude, which is really still very substantial?

MR. PRELL. In fact, as we noted in the footnote in this Greenbook as we had in the prior one, we actually perceive the liquidation as likely to be larger than the number we wrote down in the Greenbook, given our expectation that the inventory liquidation in the second quarter would be lower. We've circulated some revised tables.

MR. PARRY. We have them. They have that in them?

MR. PRELL. Under this cover sheet are the revised forecast tables that we distributed. There is a substantial liquidation still in the third quarter. We think that is consistent with the July numbers, anticipating that in the subsequent months there will be a little less liquidation and that as we move into the fourth quarter we're going to move toward to some end to that liquidation. But even the fourth quarter we perceive at this point to be in negative territory on a GNP basis. So, we think it's consistent with the production figures and the import figures and the limited inventory data we have. But we're dealing with a very small amount of data on the third quarter.

MR. PARRY. Sure.

MR. PRELL. And there's room for a surprise, certainly.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Yes, Larry, I'd like to ask a question about Japan. We understand that just-in-time inventory management seems to be in place in Japan and certainly Japan appears to have rather high short-term real interest rates. Is there some possibility that the heavier rate of production in the first and second quarters is an inventory surge that still has to be looked at as a threat to the continued growth of the Japanese real GNP?

MR. PROMISEL. Well, it's hard to rule that out, but I wouldn't think so. I think inventories have been held in pretty good shape; in the second quarter, I'm not sure how well they did. The Japanese are talking quite a bit about the need to get investment going--I'm referring to fixed investment, not inventory investment--at this time, and they are concerned about increasing their output capacity as demand increases. My sense is that they do not have an overhang of inventories that is going to damp significantly the output rise over the near term, although we do not expect a very robust growth in Japan in the near term. We have growth fairly sluggish in the second half of this year and picking up only to about the rates of potential growth, maybe 3-1/2 to 4 percent, in 1992. So, we're not anticipating very strong growth, but I don't know that an overhang of inventories would be a major downside risk in that.

CHAIRMAN GREENSPAN. Any other questions for the two gentlemen? If not, shall we move ahead with the round table? Who would like to begin? Bob.

MR. BLACK. Well, I think getting a hand on the true state of the economy and its near-term prospects is about as difficult this time as it has been at any time I've ever been involved in it, and I've been doing this longer than I would like to remember. Much of the anecdotal information that we've been getting lately has been negative and discouraging. Of course, there is some positive news--especially in the manufacturing area--and similarly the statistics are pretty mixed. But despite all that conflicting information, I think the staff has made a particularly strong case for the kind of moderate growth that they're projecting here. And I think it's important to bear in mind that this is just a moderate [recovery] and not in any sense a strong one. Real GNP, for example, is expected to grow at only slightly above what most people assume to be the long-run economic potential. So, if this is all that happens, this recovery is definitely going to be on the slow end of those that we've had in the postwar period. Our guess is that the downside risk on the forecast, while somewhat greater than the upside risk, is not as much greater as most people appear to think today. We're all aware of the downside risk presented by such things as the weakness in M2, apparently continuing restraint on credit supplies to some industries and in some geographical areas, the fiscal restraint in the federal and the state and local government [sectors], and the heavy overhang of commercial real estate throughout the country. But balancing all these negatives, at least to some extent, are strong increases in the leading indicators of manufacturing activity, an apparent reduction in the underlying inflationary pressures--although Mike did explain very clearly that that's not an unambiguous signal--and the substantial reductions that we in the Federal Reserve have effected on short-term and long-term rates.

The one aspect of this recovery that does appear to be clear to me, really, is that we have made substantial progress toward reducing inflation or the underlying trend rate of inflation. The staff's projection of about a 3-1/2 percent rate by late next year in the context of continued moderate real growth seems pretty reasonable to us. And if we can get 3-1/2 percent next year and then maybe 2-1/2 percent in 1993, then I think we will be closing in on what is effectively price stability. Now, I'm certainly aware of the risk that excessive monetary restraint could damage the economy and its apparently precarious position and that we could make it more difficult, if not impossible, to achieve sustained price stability. So, we definitely want to exercise a degree of caution. But at the same time I think it's important that we not be too cautious. We clearly have some momentum in reducing the inflation rate now; our credibility is growing and that will not only increase our chances of attaining our goal but will also reduce the cost of attaining it.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Twelfth Federal Reserve District economy is producing mixed signals at the present time. Several sectors are reporting continued declines. For example, unlike the recovery occurring elsewhere in the nation, the District's manufacturing sector continues to contract. California has been particularly hard hit, having lost 38,000 aerospace jobs since January of last year. Banks are reporting loan levels that have fallen faster than in the nation as a whole; total loans are down 3.6 percent from the level a year ago. Retail sales are reported to be sluggish throughout most of the District, although in the states of Arizona and Idaho there is the report of strength. Construction and real estate activity are weak, with continued job losses in July reported in the District; and nonresidential construction activity remains weak, particularly in California. Residential sales, after rebounding in the spring, have declined for three consecutive months.

There are other indicators, however, that are turning positive. Total employment in the District rose in July for the first time in six months. The July increase occurred in all District states except Alaska, and it left the District's employment approximately 0.2 percentage points over what it was a year earlier. Trade employment rose for the first time in six months while service jobs were added at a solid 4.7 percent annualized rate between June and July.

If I can turn to the national outlook, we expect to see a modest recovery over the next six quarters, and I'd say it's roughly at the same pace as that in the Greenbook, assuming that the value of the dollar is constant. In the near term we expect that the main sources of growth will be in household outlays on durables and housing plus a switch from inventory liquidation to inventory accumulation. And then next year we would anticipate a turnaround of business equipment spending. We are optimistic that a moderate recovery would be consistent with moderate declines in both the inflation rate and the unemployment rate in the period. We also believe that there is a chance that the dollar may drop as much as 10 percent over the next year and a half as long-term interest rates fall and also as the U.S. demand for imports grows. If that were to happen, that path of the dollar would add approximately 1/2 point to the growth rate of GNP next year but also would add 1/2 point to the inflation rate by early 1993. Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. In terms of the District, New England has changed very little since the last meeting. In fact, a sense of resignation is beginning to accompany the pervasive sense of gloom. Confidence at the consumer level about both current and expected conditions continues to decline; we're in a range that's somewhat worse than the national level. And partly as a result of this, retailers we talk to are extremely nervous about the Christmas season. They are going in with very light inventories; there has been a lot of inventory liquidation so far and they are planning on quite light ordering for Christmas. In fact, now they're seeing some lost sales because of not having goods on the shelf and that's reflected also in indications that discounting has diminished in some of these cases; but they're not about to increase their inventories for a while. Manufacturers by and large see some bottom but no real rebound. Again, they are very nervous, very cautious on capital spending, and have continued plans for restructuring and reducing employment. There is concern in the aerospace sector, which in our area involves feeder industries; they are particularly concerned about what may happen to the B2 program. Actually, it's interesting that in the District as a whole we saw a reduction in the labor force last year of about 1 percent. Some of that I think is people moving out and some of it is the discouraged worker phenomenon.

In the financial sectors there is obviously a lot of continued restructuring going on. Much of this, if not all, is very necessary; but it obviously will have a transitional impact on the labor market and the commercial space market. It is an interesting phenomenon. In the space market alone there is an enormous amount of jockeying going on as developers who have buildings just completed or about to come on line try to compete to steal tenants away from competitors by knocking down lease prices quite a lot. From the standpoint of the economy as a whole, while this restructuring certainly has been an important and necessary long-run phenomenon that we don't want to stop, it does constitute a drag on the economy, particularly as it affects many people who usually haven't been impacted by recessions; and it affects their confidence. Residential real estate in the District has softened but one would expect with the mortgage market improvement that there will be some turnaround. Unfortunately, in what I think has to be on balance a negative report with regard to District business activity, on the inflation side we did have one interesting labor contract, the NYNEX contract, that will affect to some extent at least the management of the New England division of NYNEX. It's a fairly rich contract--about 13.2 percent over three years. It actually had to reverse the previous deals in trying to [introduce] cost sharing for medical insurance where [unintelligible] program as long as the company would pay for it fully. This was traded off [for other concessions] and we'll see if the productivity returns come in. Management expects that they have gotten some significant work rule improvements, but we don't know. And they're continuing to cut management employment. But I think it was really buying labor peace at what I thought was an unusual time in the cycle.

As far as the national scene goes, I think it's very, very hard to find a central tendency in the forecast that would be much different--or one that I would have much more confidence in--than what the staff has produced. I find myself very much in sympathy with Mike's views of the risks as far as the outcome goes. I would think that they're slightly on the down side but not greatly.

From my perspective what this comes down to, since it's all a game of risks, is: Which side is the worst if we are wrong? My own view is that I would prefer to be wrong on the side of having a little stronger growth than somewhat weaker growth, at least in the short run, because I am concerned about the financial sector. We have talked about many of the [financial sector concerns]. We would be quite a ways away from potential if the economy were to come in--instead of, say, at 3.3 percent growth, which is the central tendency --at something like 1.8 percent rather than 4.8 percent growth. That implies further stresses on the system--[more than if] we were to have 4.8 percent for a short period of time. As long as we're willing to reverse course, I think that the latter could be dealt with more easily than coming in with a very slowly growing economy.

Depending upon the state of confidence, I think we could see a quite slow Christmas season. I admit that there are strong offsetting risks that imply a rather evenly balanced outcome in terms of what may happen to the economy. Again, my views are driven by which side I would rather be wrong on, in terms of the effect of being wrong.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, in the Chicago District at least we seem to be in something of a steady state. Really not much has changed in total context since the last meeting. In a comparative sense our numbers seem a little better than the national averages. On employment, for example, our numbers have shown a little less erosion than the national numbers; excluding Michigan, which of course has its own very obvious problems, some of the employment numbers are looking at least flat to up a bit. Manufacturing activity is showing some sign of modest improvement. The steel business, for example, is operating at a higher rate, and at least one manufacturer would anticipate that their operating rate would go up pretty close to 100 percent by the end of October.

As has been the case all year, so much is very, very dependent on the auto industry. And I must say at this point that I find it awfully hard to get a grasp on what the underlying retail demand for cars is. The early September sales numbers are a little on the disappointing side, but it is expected that fleet sales during the last 10 days will boost sales for the month as whole. The industry obviously is hoping for a better fourth quarter and the forecasts for sales of cars and light trucks seem to be coming in at about 13.6 million at an annual rate. But they do admit that that could be a little on the optimistic side. Based on that sales expectation, their production schedules for the fourth quarter have been set at levels quite a bit higher than the fourth quarter of last year and higher than the third quarter of this year. But, again, the caveat or the production risk is on the down side. Looking back at the third quarter, of course, they had production schedules that were forecast at quite a bit higher level than actually took place. If the sales fail to live up to expectations and production is cut back, that of course would work back onto the suppliers. A lot of the order increases that steel manufacturers have are based on auto production, but these are orders that are cancelable. We're just going to have to wait and see how all this works out in coming weeks.

In the agricultural sector, despite the drought in parts of the District--it's particularly tough in central Indiana--and now the early frost, production is going to come in at a reasonable level. Corn is down just a bit from last year; soybean production is probably down a little more. The impact in the District in terms of farm income is nothing like what we experienced in '85 or '86 when we went through a big correction, barring even the drought of '88. And the ag banks do not anticipate a significant deterioration in the permanent aspects of agricultural loans.

On the price inflation side, I must say the situation continues to look positive. Competitive conditions are just too tight and too tough to provide much latitude for price increases. The steel industry, for example, has announced a price increase for sheet steel. They think it will stick, but major users of steel say it will not stick and that they will be able to beat it back down. On the wage side, there is not much change other than, I would point out, that Caterpillar is really in a very tough negotiating stance--really a non-negotiating stance. They anticipate a strike and final settlement coming out of that at a very low rate--at about the settlements of some of the other UAW contracts.

In a national context, our numbers, certainly for the third and fourth quarters of this year, are quite similar to the Board staff's. But I will say that our forecast for next year is a little lower than the staff forecast. The main area of difference is in personal consumption for durable items and in turn for disposable income; our numbers are lower there as well. So, I would argue that the staff forecast is a little on the positive side as we get into next year. And, net, while the recovery seems to be developing along the lines that we've been anticipating, the main question is the one that Ed Boehne raised: whether this recovery is going to be strong enough to get enough of the boats off of the bottom to sustain it for a continued period.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, when we were together in August I reported that economic activity in the Sixth District was very slow and uneven and, unfortunately, that hasn't changed at all. In fact, the people that we've been talking to over the past several weeks would describe the local economy, and to some extent the national economy, as one that really is struggling to maintain any forward momentum. Retailers are experiencing flat sales; they've been very disappointed by the back-to-school season. They're also seeing, of course, weakness in durables as is the trend around the country. They are very concerned about sales in the upcoming Christmas holiday season and are not really expecting very much from that. I would say that confidence continues to be low. The sentiment in the District is reflected in the general comment we get from business people: If we're really in a recovery, why doesn't it feel better?

On the other hand, industries that are in any way related to the export side are doing a little better; and that includes, for example, industries like chemicals and poultry processing. Manufacturing inventories continue to be quite lean. Another positive note is that single-family housing inventories seem to be declining, though declining at a fairly slow [pace]. And building activity and sales seem to be improving a little. However, in two of our major markets, Florida and Atlanta, the momentum in housing seems to be declining and there's some evidence that it might actually be stalling out. Adding to the gloom generally in the area, state and local governments have experienced revenue shortfalls and are cutting expenditures quite stringently, with the exception of Louisiana, which has benefited somewhat from the oil situation. There are no price increases to be reported at all.

On the famous credit crunch side, that problem still seems to be with us in the Sixth District. Bankers say they are willing to make loans to creditworthy borrowers but it's pretty clear to me that the standards for gauging credit quality are pretty stringent and haven't changed very much over the last several weeks. So, in summary, it seems to me that the Southeast--the Sixth District--is experiencing activity very much like the nation as a whole, with the same mix of strengths and weaknesses.

On the national side, we're fairly close to the Greenbook forecast, but we do show somewhat slower growth, particularly next year, and somewhat higher inflation. We agree that the recovery is going to be slow; it's probably going to be pushed by manufacturing. I'm somewhat concerned that our forecast--not only ours but forecasts generally--have been a bit more optimistic than the reality and I hope that upcoming forecasts will prove to be a little more realistic. But as I look at the overall characteristics of the economy nationally what I see is: modest growth in consumption expenditures with households and businesses constrained by high debt levels and limited income growth; a housing sector that's still adjusting to slower rates of family formations--the demographic situation we've talked about; a nonresidential market that has a three-year supply of office space; and negative fiscal impulses at both the state and the federal levels. When I add that up and add to it the balance sheet position of individuals and businesses, which is retarding growth, it seems to me that the risk is somewhat on the down side. And I would ask the same question that Dick Syron asked: If we're going to make a mistake in policy, would it be better to err on the side of stimulating growth a little more? I would tend to come out on that side.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. At the national level, as has been the case for some time, I find myself quite comfortable with the Greenbook forecast. The latest readings on the economy and its prospects suggest that a modest recovery is underway and I think it's likely to continue. I would add that I'm also more confident than I have been for some time that we are finally going to see some progress in bringing down the core rate of inflation over the next year or two. So, from that perspective, the outlook to me looks reasonably satisfactory.

In the District, recent meetings that I've held have had a surprisingly positive tone. But I think that's because they've been very District-specific. By that I mean that they focused mainly on agriculture, which for the most part is having a good year; on tourism, which has had a good year; on residential construction, which in parts of the District at least is doing surprisingly well; and on retail sales, which have been boosted substantially by Canadian shoppers apparently flooding across the border and stimulating activity all across the northern tier. So, from those perspectives, things really look quite positive. On the other hand, if I talk to business people whose businesses are more diverse geographically and who do business nationally and internationally, attitudes really are terrible. I've been trying to understand why, without a lot of success, because I don't think the aggregate data that we look at are as bad as the attitudes would suggest. Part of the explanation may be that business people simply expect, and indeed want, stronger and more rapid improvement in activity than they are experiencing. Part of it may be the pricing situation; my general impression is that it would be very difficult these days really to get any kind of price increases at all. And that may be affecting them, of course, both directly and through the profit side of the business.

CHAIRMAN GREENSPAN. Ed Boehne.

MR. BOEHNE. Except for manufacturing, there are few signs of growth in the middle Atlantic states. There's continued weakness in the labor markets and joblessness--the number of people who are out of work--is still rising. The word from the retailers in the District, and the statistics do back it up, is that retail sales are fairly flat, with not much expectation of a Christmas season that they will feel comfortable about. The banks and the financial sector generally are still quite sluggish and the overhang of commercial real estate is still there and will be there for some time. On the whole I sense that the District is somewhat weaker than the nation and attitudes are at best cautious.

As far as the national economy goes, I hope the Greenbook is right. I always feel better when I hear Mike. The trouble is that when I get back home, it doesn't last long; it's a quick fix and I need more of it to overcome what I keep running into. But I think the risks are on the down side both for growth and for inflation. And then I ask myself the question that Dick raised earlier: If we miscalculate, nine months or a year from now which miscalculation would we rather have? If this incipient recovery should slip away from us--though I don't happen to think it will--I think it would be very difficult for us to rev it up again. I would prefer to try to slow down a faster recovery than to try to speed up one that isn't moving along. So, I think the risks are on the down side and the costs of the downside risks are higher than coming out on the up side.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I think it's time to remember that we are 28 months into this period of declining short-term interest rates. The fed funds rate is 465 basis points lower than it was 28 months ago. This was accompanied, of course, eventually by a shift from a flat yield curve to a very positive yield curve. That very positive yield curve has been in place for quite a few months. We're looking, then, at a shift in behavior in the commercial banking system as well as the nonbank public in regard to their positioning of assets. The commercial banking system is shifting heavily into U.S. government securities. This is quite typical at this stage of the interest rate cycle that we're in. Undoubtedly, when commercial banks begin at the margin to add to their holdings of government securities and to offset that by some shrinkage or no growth in loans that, of course, means that the opportunity costs of making a new loan are moving in the direction of alleviating the credit crunch. So, it seems to me that we have fully in place the atmosphere that does provide for the kind of forecast that Mike has described. To me the one factor that was most noticeable in Mike's statement was that the Blue Chip forecasters have a slightly lower rate of economic growth but a slightly higher rate of inflation. And I guess, Mike, that maybe we have inside information. But the critical question before us puts me somewhat in disagreement with those who talk about where the risks are. The critical risk that we run at this stage is that we do not make the gradual progress in the core rate of inflation as Mike has outlined. And if we go past this window and find ourselves with the same basic core rate of inflation we've had since 1984, you can better believe that we will pay for that yield structure and the term structure of interest rates in the future, and that certainly will be a very significant factor with regard to the size of the U.S. government debt and the interest payments that will be there.

So, I feel that where we are is just about right. I don't see how it could be much better. It seems to me that it would be better for us to have 2-1/2 percent real growth rather than 3-1/2 percent real growth and make the progress in [reducing] the core rate of inflation. The environment that we're in, if we maintain it, came after a period of patience, which may mean that the rate of inflation, and the rate of [unintelligible] may come down more in the next 12 months. Yet we're looking immediately at financial markets that [have yet] to adjust to news in regard to what we think the third-quarter GNP numbers are going to be. It's entirely possible that given those numbers--[growth in] real GNP in the third quarter at the 3 percent level--that we could see the long bond yields rising above this nice 7.79 percent where they now appear to be. So, we have in front of us a very delicate matter. And it seems to me that the best prospects for growth will rest with further progress in [lowering] the core rate of inflation. So, I'm very pleased, but I would be happy to have Mike be 1/2 point too high on this real GNP number.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The economy in the Dallas District, Mr. Chairman, has improved somewhat since the last FOMC meeting. Over the summer we experienced some employment gains, after about five months of no gains. District manufacturing activity has gone along with the nation in being stronger than the services areas. The strongest part of manufacturing has been in chemicals, petroleum refining, plastics, and also some construction-related manufacturing. Construction has picked up slightly in residential areas but not in nonresidential areas. The energy sector remains weak primarily because of the prolonged decline in natural gas prices. Rig counts in the District are down about 5 percent in the last month and down 21 percent over the past year. Retail sales have languished in recent weeks and remain well below year-ago levels. Our directors and other people we talk to and get anecdotal information from have the feeling that we're stuck in the mud--that forward progress is not necessarily being sustained. They're still very concerned with what is going on with bank lending and they're concerned about the sectors of the economy--the small business and medium size business sectors--that are still relying heavily on the banking industry as opposed to someone else for their financing.

CHAIRMAN GREENSPAN. First Vice President Hendricks.

MR. HENDRICKS. Well, I'm pleased to be here with you again. Several of you commented that you'd rather see Lee at this chair than me and I agree with that; I certainly would. Nevertheless, in our District we are cautiously optimistic about prospects for further gains in output as inventory cutbacks near an end. Our District contacts tell us that they're reasonably satisfied that retail stocks are at about the desired levels. Manufacturers, especially of motor vehicles, steel, and major appliances, have for the most part cleared their inventories. We also see scattered signs of a comeback in capital goods out there. Several industry sources believe that their business is either near a trough or in the early stages of recovery. This is especially the case with producers of industrial equipment, industrial controls, heavy duty trucks, small electric motors, electrical equipment, and ball bearings. But I would hasten to add that the recovery in our District is not yet broad-based or very strong. Our directors do not yet see much of a recovery but their attitudes may be based more on year-to-year comparisons or on their memories of pre-recession operating rates, when they expected to be at 85 percent or more [of capacity]. Still, we feel that the latest purchasing agents reports confirm that manufacturing has been in an expanding phase in recent months; and that should continue, albeit less rapidly than many would want. That concludes my remarks.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, recent public attention has been focused on the banking sector being the skunk at the garden party, which is restraining more vigorous growth in the economy. I have a somewhat different view. I believe that the credit crunch isn't [the issue]. I believe it's not so much that banks are not lending as it is that borrowers are not borrowing. It is true that bankers' confidence has been badly shaken by savage examination experience, a slack economy, and stiffer capital requirements; but they can hardly abandon their basic business, which is lending money. I think the anecdotal evidence favors the conclusion that it is weak demand rather than lender reluctance that accounts for the credit contraction. Consumer confidence and business sector confidence are weak and are not likely to be stimulated by further interest rate changes. Some solid good news about the economy is far more likely to stimulate demand than a 25 or 50 basis point cut in the fed funds rate. I hope we don't lose patience with the pace of recovery if we have confidence in the staff analysis, and I do. In the past, we have had a tendency to ease too much and too long; and I hope this time that we can keep our eye on the target of price stability and not over-stimulate the economy.

CHAIRMAN GREENSPAN. Well, John, I'm glad you liked the waffle! Vice Chairman.

VICE CHAIRMAN CORRIGAN. This is going to sound as if it was orchestrated, but it was not. Amid all these anecdotal reports, Gary's people must be sending the people in Minneapolis to talk to me because I hear all this terrible stuff too. But staff at the Bank yesterday were walking me through some [analysis] on the household sector, which actually made me feel a little better. Some of it Mike already referred to and indirectly John referred to it. We all have this impression that the saving rate is very low, that income growth is rather sluggish, and that spending is rather sluggish. But if you look at it in the context of these NBER charts, you find several things. One is that the saving rate never falls in the beginning of a recovery. What that means, of course, is that it is income that pushes up spending, not the saving rate falling. And when you look at the income side in this recovery, it's sluggish but certainly not disastrously so. I think that was part of what Mike was saying before. And neither for that matter is overall consumption spending or even so-called discretionary consumption spending all that wildly out of line with what one might expect. On the other hand, nonagricultural employment is a bit weaker, but interestingly enough that is not in manufacturing; it's not even in construction. It's basically all in services, with particular emphasis on finance, insurance, and real estate, and in state and local governments. And, of course, those problems are as much secular as they are cyclical. What that basically says is that if you look at the dynamics of the consumer sector in the context of income, employment, and savings, despite the fact that nobody feels very good, it's not all that unusual looking.

There's another side to it, which gets to John LaWare's point that I found even more interesting. And that is what has been happening to the household balance sheet. When you look at that household balance sheet in flow-of-funds terms, what you find is that the contraction in the growth of household debt doesn't look all that unusual either. The only thing that's unusual is that it started a little earlier than it normally does and that the fall in the growth rate of non-mortgage debt started distinctly earlier and has been much steeper. But that probably reflects the 1986 Tax Act as much as anything else. But as the rate of growth of debt falls, if you believe in a balance sheet, something else must happen. And of course when you look at the last four or five years as a whole, the saving rate on balance hasn't really changed at all. Therefore, what we find, which isn't surprising, is that over that period the growth in the acquisition of financial assets and the acquisition or increase in liabilities are very, very similar. And that, of course, makes the overall situation look even more typical. But it turns out--and this is the thing I didn't really have a clue on--that there is one very big difference in terms of the financial assets side of the household balance sheet over this four-to-five year period, and that is a very large atypical shift in the composition of household financial assets out of bank deposits into various securities-type instruments, including government securities funds and so on.

CHAIRMAN GREENSPAN. The financial funds.

VICE CHAIRMAN CORRIGAN. Well, even the mutual funds are a part of it, but it's also the government funds. Now, that big relative drop in bank deposits, of course, we see in the context of the rate of growth in the money supply. But if you think of it in this broader context, it seems to me that the pattern as a whole is quite consistent with the hypothesis that it's being driven importantly by the desire to shed debt, which is quite consistent with John's point about the demand side of the equation being more important than the supply side. Indeed, it's also quite consistent with the hypothesis that the portfolio shift phenomenon, which in part is being facilitated by technology, may have an important role here as well. Now, the reason why that makes me feel a little better in the context of the earlier comments about income, consumption, the saving rate and so on is that, to the extent it is significantly driven by purposeful decisions to manage the balance sheet better and shed debt, it also makes me at least less nervous--I'm still nervous--about the money supply and about the credit crunch. That's not to say that I think I understand the money supply and it's not to say that there are not elements of the credit crunch there; it's simply to say that it makes me feel a little better about them and therefore a little more comfortable with the kind of forecast that Mike has on the table.

I'd quickly add, Mr. Chairman, on the anecdotal side, that the attitudes one hears about, especially from big businesses, are still lousy. The only other thing--I don't remember if I mentioned this at the last meeting or not--is that I do get the sense that the commercial real estate market in price terms may be bottoming out, at least in the greater New York metropolitan area. There's still going to be a long workout, but one does begin to get the feel that the precipitous--

CHAIRMAN GREENSPAN. Commercial and not residential?

VICE CHAIRMAN CORRIGAN. That's right.

CHAIRMAN GREENSPAN. You're talking now about the rental prices flattening?

VICE CHAIRMAN CORRIGAN. Sale prices.

CHAIRMAN GREENSPAN. Sale prices are flattening, which means that the rental prices are flattening?

VICE CHAIRMAN CORRIGAN. Yes. Now, that's still in the straw-in-the-wind category, but I now have had enough people say that to me that I can't dismiss it.

CHAIRMAN GREENSPAN. New York was the leader in going downhill in certain respects.

VICE CHAIRMAN CORRIGAN. Well, it's not just the City. I get this now from northern Jersey too, anyway. Ed, I don't know what they're saying in southern Jersey, but certainly in northern Jersey--

MR. BOEHNE. Northern Jersey has more excess than south Jersey. But Jerry's point is that probably in relative terms there's more excess space in the suburban areas than in the central cities.

CHAIRMAN GREENSPAN. Bob, what is your judgment of commercial real estate price trends in the last month?

MR. PARRY. That they're weak and probably have come down.

CHAIRMAN GREENSPAN. Does anyone else sense this?

MR. BOEHNE. I sense that rental prices are still coming down but that sale prices in the Philadelphia area are in the process of flattening out.

CHAIRMAN GREENSPAN. Commercial?

MR. BOEHNE. Commercial buildings.

CHAIRMAN GREENSPAN. The relevant rental prices are the new lease rental prices because the average is going to come down for a long period.

MR. BOEHNE. The new lease prices are still very weak.

CHAIRMAN GREENSPAN. Have you seen anything, Dick?

MR. SYRON. I think the new lease prices have weakened but are stabilizing. We have levels that are substantially below what they were before but I think that they are reaching--

CHAIRMAN GREENSPAN. Bob, is there anything in Texas?

MR. MCTEER. I don't think there's a lot of activity there.

CHAIRMAN GREENSPAN. Does anybody else have any sense of developments?

MR. FORRESTAL. Rental prices are still weak in the Atlanta area.

CHAIRMAN GREENSPAN. They have to start somewhere.

VICE CHAIRMAN CORRIGAN. Look, don't misunderstand me. They are weak in New York. But what I'm saying is that they appear to be--

CHAIRMAN GREENSPAN. The rate of decline is [abating]?

VICE CHAIRMAN CORRIGAN. Well, that's clear. The rate of decline has abated, but my impression is that it is beginning to sound as though people think it may be bottoming out.

MR. SYRON. It's different in suburban areas and the central city. In Boston, where obviously it occurred earlier than in some other places, the class A space seems now to be going for \$21-\$22 and that hasn't changed much, I would say, over the summer.

MR. LAWARE. It's half of where it was four years ago.

MR. SYRON. That's right.

MR. PARRY. I think the weakness in prices and its continuation are broadly consistent with the forecast. If you had these prices bottoming out now and presumably moving up in the next quarter or so, maybe you would have your [projected] decline in nonresidential construction and maybe within that the commercial [sector] coming to an end. But to the extent that that forecast is correct, I would anticipate considerable weakness in prices in the months and quarters ahead.

MR. SYRON. Well, a lot of leases are rolling over and the average is obviously coming down because people are very aggressively going out and seeking to steal tenants. There are a lot of places where that is going on.

CHAIRMAN GREENSPAN. Tom Melzer, do you want to comment on this and make your report?

MR. MELZER. I don't have any comments on that particular subject. In terms of the District in general, I would say the numbers, which are necessarily somewhat stale at this point, would indicate that maybe we're at the beginning of a turnaround. I have been reporting overall employment declines. We have had pretty healthy growth in manufacturing employment in the most recent three-month period and a seeming cessation in the decline in nonmanufacturing employment, and both residential and nonresidential construction contracts are growing at pretty healthy rates. Anecdotally, I picked up a somewhat different tone. What I've been hearing, particularly from our board of directors, over a long period of time is that things are just moving along at a slow pace without any significant declines.

We were in a couple of different parts of the District last week, and particularly in Evansville I picked up some very positive comments. They all seem to go back to roughly midyear; they talked about a very lousy first half of the year. One fellow who supplies automobile parts is running [his production facilities] seven days a week and has record shipments. Another in electronic components has increasing orders. There is some talk of capital expenditures in the industrial area there. A lot of people are looking all of a sudden to relocate. It's not new construction; it will be relocated manufacturing facilities. But the observation was that people don't even look if they're not somewhat constructive, and there's a lot going on there. In general, I would say this is mostly manufacturing-driven, just given the people we had in the room from that general area.

In another area where the economy isn't performing so well, Mt. Vernon, Illinois, there was a lot of talk about credit availability. But in general I think there was a recognition that a rebuilding of balance sheets needed to take place. One thing that surprised me is that no one really attacked [the Federal Reserve] in terms of interest rates. In other words, no one said: "You've got to do something about interest rates." Now, I think if you're in areas such as Boston and the West Coast, where maybe there's a lot of real estate hung up, that interest rate pressure is still there. But in these areas there's just a general feeling that rates are not the issue. And I would say, picking up on John LaWare's point about the credit crunch, that our aggregate banking data for the District continue through midyear to show no increase in nonperforming loans; we're at roughly the same level we were at the end of last year, with less than 2 percent in nonperforming loans and yet no loan growth. So, this should be a group of bankers that isn't as shell-shocked as some others; and loans aren't growing.

On the national situation, I'm comfortable with the Board staff's forecast. I would make at least four observations. First of all, I personally don't think monetary policy is inconsistent with recovery and expansion; I think it has been consistent with that for some time. Secondly, I'm very skeptical about our ability to fine-tune the real side. So, the concept that we can somehow buy more insurance bothers me. I just don't think we'd be good enough to cash in that insurance, or however you want to describe it, when we need to. And in that connection, I think there's a good deal of monetary stimulus in train, as Wayne pointed out--whether you look at what has happened to interest rates and in particular short-term real interest rates or whether you look, as we would be more inclined to do, at the behavior of narrow money or reserves over a period of time. There's a good deal of stimulus in the pipeline and I don't think it has all shown through. In fact, and this would be my final point, our view is that if we were to continue this rate of narrow money growth for a sustained period of time, we're probably already risking a somewhat higher inflation rate than the 3 to 4 percent that we're talking about achieving in the forecast period down the road.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, it seems to me that what we've all been talking about this morning and what is at the front of all our minds is a very straightforward question with a very ambiguous answer. Is this economy faltering or is it going to falter? If we knew the answer to that question, we'd have a pretty good idea of what to do about policy. The staff forecast is that it's not faltering and is not going to. But I think the staff and everyone else would agree that the question is very much outstanding. I would certainly concur with those who say--and I've said here before--that the consequences of a falter are very severe. And we have to keep that very much in mind and be very concerned about it. But it seems to me as we ponder policy right now that we have to keep in mind the fact that we have a good deal more stimulus coming from what has already been done. Staff studies have indicated that the stimulus that we're going to get from easing actions to date is going to peak in late '91 and the first half of '92. The major part of it is still ahead of us. We all know how much rates have come down. Wayne Angell mentioned 450 plus basis points in the last 28 months. The aggregates may be beginning to move; it is very tentative yet. But I think one can make the case perhaps for this sticker shock and that the portfolio shifts are beginning to abate and may be in the course of beginning to move a little, which will help the aggregates. We just had a drop in the prime rate. Mortgages just went under 9 percent for the first time in a long time. Yields on long-term Treasury securities just went under 8 percent. There's some help still on the way. It seems to me that policy help right now, to the extent that it can be provided and is needed for the economy, may be to reinforce the downward trend in long rates. We have an incipient view now that inflation is going to improve, and we need to encourage that. It seems to me that the best way to do that would be to try to see if we can't hold short rates for the moment.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I don't have much to add on the real economy. We expected a moderate recovery and we're getting no better than that.

There still is some sense that it hasn't really taken root, although the evidence is pretty clear that we're getting a manufacturing rebound. I had some sense from the anecdotal evidence that this recovery may have lost some of its steam in late summer. That certainly happened in the housing area, but--as both Mikes mentioned--the recent retreat of mortgage rates might rekindle that faint flame. Consumer spending appears to be holding up, again growing with moderate growth in income. From the real side what concerns me is that after this manufacturing recovery and the inventory side of it, it remains difficult to identify the sources of final demand that are going to move the economy forward. The government sector remains bleak. Perhaps we can expect an uptick in business spending next year; attitudes are not too encouraging, but they never are. And on the consumer side, consumers can only spend at the modest rate of income growth. So, I think the final demand side late this year and early next year is a concern.

On the financial side, I still see some weakness. It's true that the public capital markets, the investment grade sector, look fine. As the long bond rate has come down, bond issuance has picked up smartly. The stock market has been marking time for six months now; still, we're getting a fairly healthy volume of new stock issues. For below investment grade businesses--small and medium-size firms, which are the growth sector of the economy--I still think conditions are [poor]. Demand is certainly weak; at some stage demand should be picking up. I wonder why we hear so much about credit constraints if they're not out there. In the beginning, I thought it was commercial real estate developers; I would assume by now most of them are broke and not able to complain! The jury is still out on the capacity of the system to satisfy loan demand should it ever arrive because I think banks are focusing on increasing capital, working out problem loans, and rationalizing operations with mergers. One way I would [phrase] the question confronting us on the financial side of the economy is: Are monetary conditions tight or easy? You can pick your indicators here. M2 conditions look tight, with unprecedentedly slow growth in M2. We've discussed some of the issues there. What would concern me most is the credit side and less so the portfolio side. M1 growth continues to look healthy; maybe it has tailed off a bit, but it continues to look healthy. We have little confidence that M1 is related reliably to economic activity. Some would suggest even that the reliability of the M2 relationship could be called into question. Look at credit growth. Conditions also look tight; but, again, that could be demand. If you look at interest rates, we've brought short-term rates down substantially, as has been mentioned, and that looks like ease. Of course, it's real rates that matter and with CPI inflation of 5-1/2 percent in 1990 and looking at perhaps 3-1/2 percent in 1992, real rates have fallen less over this last year than nominal rates. So, there has been less ease than would be apparent just looking at the rates. Real Treasury bill rates are higher than they have averaged over the long sweep of history. Over 60 years the real T-bill rate has been zero. Currently, it's probably 1-1/2 or 2 percent, although it is probably marginally lower now than the rate that prevailed over much of the '80s. It's roughly in the same order of magnitude as the '80s; of course, the '80s was a different environment, characterized by growth in credit demand.

If you're interested in stimulus to final demand, you might look at real rates paid by final borrowers; perhaps they matter. If you think of real rates faced by bank borrowers, they would still seem to be pretty high. As Chairman Riegle pointed out the other day, the last time the discount rate was 5 percent, the prime rate was 6 percent, not 8 percent as it is now. It is true that over the last year the federal funds rate has fallen 300 basis points; the prime rate has fallen only 200 basis points in nominal terms; and the real prime rate has fallen even less. With respect to real consumer bank rates, I would suspect that we've had little, if any, easing in those rates; maybe they've come off in nominal terms a bit, but I doubt if we've seen much easing in those rates in real terms. And it's not clear why we should expect much stimulus from that source. So, it does seem to me that the financial system is inherently tight currently and is not transmitting our easing actions fully through to final borrowers. I think one sees this if one looks at money growth, credit growth, or real rates, which for many borrowers still appear high.

We are concerned about flagging final demand out there in a couple of quarters. It could be that in this environment we may need to offset some of this inherent tightness; and lower rates may be necessary for the ease to show through to final borrowers and produce the stimulus we would normally expect from our actions thus far. I realize this argument applies most forcefully only to a segment of the financial system: the banking system, and perhaps insurance companies in an institutional system. However, those without access to the capital markets do constitute a significant sector of the economy in terms of size and I think in importance in terms of stimulated growth. And even in the capital markets, we must recognize that real rates have fallen less than nominal rates. I would also mention parenthetically here the point that Mike Prell made based upon Ted Truman's work: that the rise in the dollar this year has also offset much of the apparent ease. So, the bottom line is: I wonder just how stimulative policy has been. I fear that it might be tighter than we have intended. I also feel that at the current stage we continue to receive data consistent with weak recovery. We've made a couple of moves in the last six weeks and these have been well received by the long bond market and precipitated the reduction in the prime rate. So, it may be wise to continue to assess developing responses to these actions before moving again. I hesitate in part because I wouldn't like to miss that opportunity that Governor Angell mentioned. I do think, though, that if the economy sinks into recession early next year, that would not be helpful to pursuing our ultimate goals. So, I do see risks in waiting too long for the financial system to ease on its own. We may need to do more to offset what I see as an inherent tightness, if we're concerned about this issue of the level of final demand later this year and early next year.

CHAIRMAN GREENSPAN. Anything further? Does anybody else want to make any comment?

MR. HOENIG. Mr. Chairman, do you want to hear from our District?

CHAIRMAN GREENSPAN. Well, I did, but I didn't want to push you, Tom.

MR. HOENIG. I appreciate that.

CHAIRMAN GREENSPAN. I thought you might just like to sit here and listen for the first time.

MR. HOENIG. I might just make a couple of comments that might be of some value.

CHAIRMAN GREENSPAN. Please do.

MR. HOENIG. Our District economy has been growing fairly modestly, and I think it's particularly important that this has happened in the manufacturing area as well. Our automobile manufacturers are operating at capacity. And while our aircraft industry, which is important in parts of our District, had a downturn in the first half, it is anticipating some recovery, which is good news for us. I might mention that residential construction activity in our area has been picking up, but nonresidential has continued to languish, although not as seriously as in other parts of the country. I might even mention that in Denver, although there's not a lot of activity, there is an appearance that lease rates are firming up and that is important to us.

In agriculture, the situation is very similar to what you've heard here. There is some strengthening in crop prices but cattle prices have been falling fairly importantly and we anticipate about a 10 percent decline in agricultural income in our part of the country. Energy also is weak, particularly in the natural gas area. It has been very harmful to our Oklahoma area where prices have been down and therefore rig activity has been falling as well.

On the national economy, I would like to mention that our analysis is, like others, very similar to what is in the Greenbook. We are a little more pessimistic in the consumption area and net exports but a little more optimistic on the investment side. We think it might be even stronger if long-term rates were to continue to come down. We are also in agreement with the projections on inflation being less than 4 percent. We think that's a very important focus as we go forward because that will help long-term rates to come down and that will have a much more important stimulus on the national economy. So with that, Mr. Chairman, I'll make my remarks short. Thank you.

CHAIRMAN GREENSPAN. Thanks, Tom. Why don't we break for coffee?

[Coffee break]

MR. KOHN. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don?

MR. PARRY. The forecast of M2 is adjusted; how are the errors treated?

MR. KOHN. Well, judgmentally.

MR. PARRY. In other words, using the model, we would have gotten numbers significantly higher than in the Bluebook?

MR. KOHN. From here on out you mean?

MR. PARRY. Yes.

MR. KOHN. Yes, about 3 percentage points higher.

MR. PARRY. Okay, so in effect you're saying--

MR. KOHN. The growth rates we'd be seeing would be more like 6 percent than 3 percent.

MR. PARRY. Do the errors deteriorate or are you basically--?

MR. KOHN. Yes, we have smaller errors in the fourth quarter than we had in the third, but the errors are still substantial--on the order of 3 percentage points. In the third quarter we had an error in our model of 6-1/2 percentage points.

MR. PARRY. Okay.

MR. KOHN. Our projection is that whatever mysterious forces were causing that will abate, in part because people with MMDAs, savings deposits, or other deposits have had a chance to reallocate their portfolios.

CHAIRMAN GREENSPAN. Further questions for Don? If not, why don't I get started. We have a very unusual set of problems, but the least difficult strikes me as in the area of policy. The reason I say that is that at this stage we seem to be treading what in retrospect is very likely to turn out to have been the right path. If we go back historically, as Jerry and a number of others have in this discussion, what is clearly happening is a long-term phenomenon where in the first half of the 1980s, in part as the result of the 1981 Tax Act, we created an extraordinary expansion of credit. The grossing up in the flow-of-funds sense of both the funds raised per dollar of nominal GNP and the degree of intermediation were all fairly extensive. There was a really major financial expansion. It finally petered out somewhat in the middle part of the 1980s and then got really dragooned with the 1986 Tax Act, which took away all of the real estate incentives that had been the major spark that had engendered the credit expansion.

Since that period we have had the grossing coming down dramatically; by the grossing I mean the types of activities in which state and local governments borrowed at the [tax exempt interest] rate, invested at the Treasury rate, and picked up a guaranteed rate of return. There was a lot of that going on. I'm talking about the very large amount of borrowing against realized capital gains and the sale of existing loans, which built up the balance sheet. The whole thing was really quite explosive, and all of that is now in the process of turning around and, in fact, has been turning around for the last four years. It is not something that disturbed us particularly until it began to fall into the money supply area.

This may be premature, and I suspect it is a little premature, but I think what is occurring is that we're beginning to find that if past relationships on M2 were in place--or as Don likes to say "in train"--we probably would have a much weaker economy right now than is currently the case. Now, that's a very tentative statement because we really don't have enough evidence. But if one were to look back from, say, February 1992 and ask "How does this all look?" I have the impression that the hypothesis that Don raised may have some validity: namely, that the S&L evaporation has more to do with the money weakness than I think we realize. In principle, we have always argued that M2 was determined essentially by the choices of the holders, which means in effect that from where the supply comes is irrelevant. And our general view about the liquidation that was occurring with respect to the resolutions from the RTC was essentially that all that money was going into other intermediary places and to a degree in commercial banks and was leaving M2 fundamentally unchanged. I think the proposition that M2 is mainly demand determined and perhaps M1 even more so really is questionable; it is by no means clear that the proposition that M2 is all [demand] determined makes any sense. And indeed with the size of the contraction of the S&Ls, it probably shouldn't be a surprise for us that we're getting as much of a contraction as we are. What is surprising is why now? Why not earlier? And that raises the question as to how quickly people adjust. As I was mentioning to Don a while back, I remember how long it took a decade ago for the 5 percent passbook accounts to disappear. People just sat there with 5 percent when they could have gotten twice that and more; it took a long while to unravel. But it's fairly apparent that when you shake somebody and say "Look!" they change. And when you have an S&L resolution, people [reset] their views as to where they should be relative to the types of holdings they have. I think that's what is probably going to turn out to be the case. This again raises as a hypothesis that when we look back in six months or thereabouts I suspect we will be looking at what really was a fundamental change going on in the structure of finance.

I think that the real economy, if one could measure it in terms of whether it is good or bad, is really not bad. Productivity has increased significantly in the manufacturing area over the years. I would suspect, although the evidence is difficult to come by, that profitability at any given rate of operation tends to be higher; that there is a great deal more competitive capability in the American business system than there was a while back; and that what we are running into is a deficiency--basically in this case the intermediary system. It surely is not in the area of bond issuance. [unintelligible], as a number of you told me the other day, indicated that the view at   is that the total investment banking industry was operating at capacity and that if there is any more issuance coming out in stocks or bonds their "due diligence" would begin to break down. We're seeing an extraordinary [volume of] financing going on in the larger companies, but we are seeing a really extraordinary pulling back in the depository institutions. I'm somewhat less inclined to take the view that John LaWare has taken. I think there _is_ a supply side effect from the capital side. I'm not sure how it's going to be resolved but it's probably the 1980s that were off, not the 1990s.

All in all, I think what we have here is that the grossing that went on throughout the '80s has come back to normal. The general net funds raised is far closer to normal, but we have a really hobbled intermediary system, which is not only the S&Ls and commercial banks but clearly the insurance companies as well. Were it not for the fact of a weakened intermediary system's effects on primary borrowings, one could argue that we'll finance the economy outside the intermediary system. But it doesn't work that way. And what I think we are seeing, as I put it to my friends at the White House the other day, is that it's very much as though an economy which is picking up steam is running against a 50 mile an hour head wind. My impression is that we'll make it through, but it will be a struggle.

Having said all of this, I think we're getting some evidence that the commercial banking problems are not getting worse. We're getting some indications that we have passed the worst in the S&L situation; we still have insurance problems but they're not getting worse. So, the question at this stage is: Can we get through the next several months? My suspicion is--and I would buy the staff's forecast on this--that we probably will. And if that is the case, what we are testing right now is a major hypothesis as to whether the money supply contraction that we are seeing really matters or whether we are seeing an economy hobbling along with insufficient finance that nonetheless will be able to make it. If that is in fact the case, we will look in retrospect and say, rightly or wrongly, that we probably have the optimum policy that one could conceive of, granted the types of problems that exist.

Now, having said all that, we're not in February looking back at something which looks as though it has been cured; we're not there yet. And I would be inclined at this stage to tread very cautiously, as I think we've done. I'd rush nowhere quickly. And that would lead me to conclude that policy should be somewhere between symmetric and asymmetric toward ease, but I'd be less inclined to move unless we begin to see further deterioration. If the staff forecast is right, and if this hypothesis about money that Don has raised is right--and I think it is becoming increasingly more reasonable--then we should begin to see some strengthening in the data within the next six weeks. If it fails and fails in an obvious way, it is telling us that this hypothesis is not correct and would lead one more toward the type of hypothesis that Governor Mullins raises. I would recommend a directive--although I personally would feel comfortable either with symmetric or asymmetric toward ease--that is more toward the latter because it's hard for me at this stage to envisage that we might tighten within the next six weeks.

Finally, let me say that irrespective of what is going on, I think we are going to have some tough public relations difficulties on the Hill, not only with the issue of Salomon but with this whole problem of a sluggish economy. An economist's view is that a recession is over when the economy stops receding; and that by definition is the low point of a cycle, the worst point of a cycle. Politicians believe the recession is over when the economy has recovered fully. And we're going to be in this dilemma, as far as I'm concerned, for a goodly number of months. But if the staff is right on the forecast--. So far things are falling into place even if the anecdotal evidence doesn't work, and I think we may well come out in that area. In any event, I spoke longer than I intended to but I'd like to put on the table as a general suggestion "mildly asymmetric toward ease," if one can characterize a directive in those terms.

MR. BLACK. Is that "B" mildly asymmetrical toward ease or "A" mildly asymmetrical?

CHAIRMAN GREENSPAN. "B."

MR. BLACK. It's "B."

CHAIRMAN GREENSPAN. I frankly would not expect us to ease right here. We could well ease; and if that happens, we might find that the economy turns around a lot faster than we now expect. President Parry.

MR. PARRY. Mr. Chairman, as you indicated, the economy does appear to be recovering from the recession; at the current level of the funds rate, the forecast for moderate growth along with some gains against inflation certainly seems reasonable. I also think that the downside risk in the outlook has been addressed by the recent decline in interest rates. Consequently, I would certainly support the idea that we leave policy unchanged at this time, and I must admit a slight preference myself for a symmetric policy here.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, while I said earlier and I still continue to believe that the risk is on the down side, I certainly hope your forecast for our looking back from February and saying our policy has been right is correct. I'm still rather nervous about where we are, but I would certainly at this point support your prescription for no change with an asymmetric directive.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B" mildly symmetric sounds fine to me.

CHAIRMAN GREENSPAN. Mildly asymmetric?

VICE CHAIRMAN CORRIGAN. Asymmetric. There are too many adjectives in these things!

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I come out right where you do but I really do feel a great loss in seeing M2 lose its meaning. I feel almost like a baby who has lost his pacifier! [Laughter]

MR. BOEHNE. Well, Bob, you adjusted when you lost M1.

MR. BLACK. It took a while!

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I favor "B" but with symmetric language, please.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. "B" asymmetric.

MR. MELZER. Which way, Ed? [Laughter]

MR. BOEHNE. I imagine we ought to have little ambiguity!

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I prefer "B" symmetric but I like "mildly" better than straight asymmetric.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. "B" asymmetric.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. "B" asymmetric.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B" asymmetric.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. "B" symmetric.

CHAIRMAN GREENSPAN. First Vice President Hendricks.

MR. HENDRICKS. We still have some concern over the continued weak behavior of M2, so ideally what we'd like is a directive between "A" and "B" with an early reduction of 25 basis points in the funds rate as reports perhaps unfold in the next week or two.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. "B" asymmetric.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. "B" asymmetric.

CHAIRMAN GREENSPAN. We're still missing Governor Mullins.

MR. MULLINS. "B" asymmetric.

CHAIRMAN GREENSPAN. And President Hoenig.

MR. HOENIG. "B" symmetric.

CHAIRMAN GREENSPAN. As I read it, I guess it falls between asymmetric and symmetric "B." But there is a majority for asymmetric by several, so I think that [unintelligble.] If we use in the directive "slightly" rather than "somewhat," I think that probably captures the sentiment. Would the Secretary read the directive?

MR. ANGELL. I was on edge wondering how you were going to do that!

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 3 and 1-1/2 percent, respectively."

CHAIRMAN GREENSPAN. Will you call the roll?

MR. BERNARD

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Black	Yes
President Forrestal	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
President Parry	Yes

CHAIRMAN GREENSPAN. Okay, the next meeting is November--

MR. BERNARD. Five.

CHAIRMAN GREENSPAN. November 5th. We have a need to have a very short Board meeting before lunch. So, if the Board members would just stay here and others would give us a few minutes to have a legal meeting, we'll be back at lunch.

END OF MEETING